by Karl O. Nygaard ☆

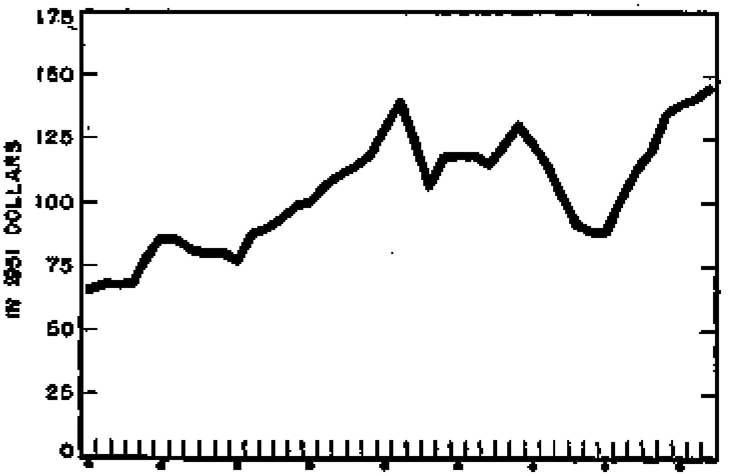
State and Local Government Receipt and Expenditure Programs

STATE and local governments, in rendering a host of vital services, exercise important direct and indirect influences upon economic activity. In 1952, the more than 119,000 such governments spent $28 billion, an amount as large as fixed capital outlays of nonfarm business and larger than Federal nondefense expenditures.

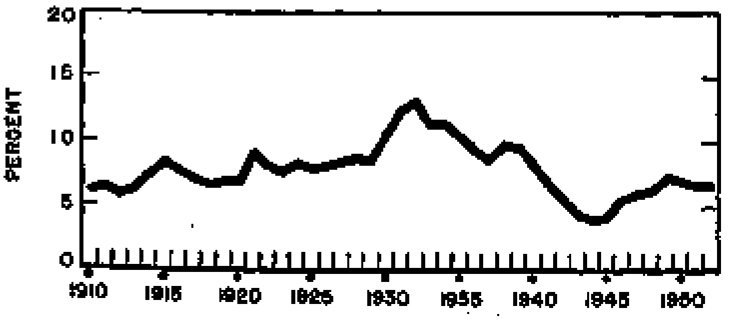
A growing popular concern about the condition of the Nation's schools, highways, and institutions is directing increased attention to the taxation and expenditure programs and the financial position of these governments. The extent to which improvements in facilities are possible and might be provided within existing financial limitations is discussed in the Commerce Department's new report, *Markets after the Defense Expansion*. The purpose of this article is to review past receipts and expenditures and to throw some light on the prospective fiscal and financial position of State and local governments as a whole.

State and Local Government Purchases

Exclusive of war and depression periods, REAL per capita purchases have shown a long-term upward trend . . .



while as a percent of the Nation's output, purchases have moved within a narrow margin



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The State and local government account

It is convenient to analyze the fiscal position of State and local governments as a whole in terms of the consolidated expenditure and receipt estimates included in the national income and product account. These estimates, presented in table 1, are based primarily upon comprehensive data from the 1942 Census of Governments and Census data from the annual summaries of city and State finances. In table 1, governmental revenues are presented on an accrual basis.

Purchases of goods and services account for the bulk of the expenditure total and include the capital formation of government enterprises. Sales and current expenses of government enterprises are excluded from the table, but their current surplus (excess of operating revenues over operating outlays) is shown as a deduction from expenditures. Thus, the deficit or surplus presents a substantially complete fiscal picture for all State and local government activities including general government, government enterprises, and trust funds.

Although a functional classification of purchases of goods and services is not possible on the basis of available data, the relative importance of the two largest categories may be indicated. Of the more than $23 billion of goods and services purchased by State and local governments during 1952, about three-tenths were for public education purposes and one-fifth for streets and roads.

A more complete breakdown is shown for State governments and cities over 25,000 population in the annual Census reports for these units. With respect to levels of government, purchases by States account for roughly one-third of the total.

Expenditure Programs

State and local government expenditures have more than tripled since 1929 with most of the rise occurring in the postwar years (see chart). Although transfer payments, including veterans' bonuses, have contributed to the increase, the bulk of it went for purchases of goods and services. In 1952, State and local purchases reached their largest annual

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total to date in terms of either current or constant dollars. When adjusted for price increases since 1929, purchases rose three-fifths.

Real per capita outlays

Real per capita State and local purchases increased at an average annual rate more than double that for real per capita national product in the two decades preceding the depression. Real per capita purchases by State and local governments fell sharply during the depression and World War II so that their present level is only slightly above that for either the early 1930's or the years just prior to World War II, despite a three-fifths increase since 1945. For the past 40 years as a whole real per capita purchases by State and local governments have increased at an average annual rate of almost 2 percent, only slightly above the average rate of growth in real per capita gross national product.

The 1952 rate of real per capita construction outlay by State and local governments, though five times that in 1945, was only slightly above that of 1939.

The proportion of gross national product purchased by State and local governments has shown no consistent long-term trends. During the past four decades, the State and local share of national product has averaged slightly more than 7 percent. This percentage was considerably higher during both the 1920's and the 1930's. During the decade prior to World War II, State and local governments purchased on the average more than one-tenth of the gross national product. However, in the war period, this percentage was reduced by more than half and despite its subsequent recovery still remains substantially below the 1920's, the 1930's, or even the 40-year period as a whole.

New construction up sharply since 1945

State and local outlays for new construction are much more volatile than their other purchases of goods and services and, as the chart shows, have fluctuated considerably in the past.

After expanding to an annual rate of more than $2.5 billion in the early 1930's—in part a carryover of the building boom of the previous decade—outlays were drastically suppressed during the following depression years. During World War II the overriding needs of the Federal Government resulted in a reduction of capital outlays to a level consistent with only the most critical needs. In both these periods, the decline in total State and local government expenditures may be traced to the fall in construction outlays.

Table 1.—State and Local Government Receipts and Expenditures in the Income and Product Account

[Billions of dollars]

	Calendar years						
	1946	1947	1948	1949	1950	1951	1952 p
Receipts	13.2	15.6	17.9	19.6	21.5	23.1	24.4
Personal tax and nontax receipts	1.0	1.3	2.1	2.5	2.7	3.0	3.3
Corporate profits tax accruals	.5	.6	.7	.6	.8	.9	.8
Indirect business tax and nontax accruals	9.5	10.9	12.3	13.5	14.7	15.8	16.7
Contributions for social insurance	.5	.6	.7	.8	.9	1.1	1.1
Federal grants-in-aid	1.1	1.7	2.0	2.2	2.3	2.4	2.4
Expenditures	11.2	14.7	18.1	20.6	22.7	24.1	26.0
Purchases of goods and services	10.0	12.8	15.6	18.2	19.7	21.7	23.4
Transfer payments	1.0	2.2	2.6	2.9	3.4	2.9	3.0
Net interest paid	.3	.3	.3	.3	.3	.3	.4
Less: Current surplus of Government enterprises	.7	.6	.7	.8	.7	.8	.8
Surplus or deficit (−)	2.0	.9	−.3	−1.0	−1.2	−1.0	−1.6

p=Preliminary.

NOTE.—Detail will not necessarily add to totals due to rounding.

Source: U. S. Department of Commerce, Office of Business Economics.

During the postwar period, the rise in new construction has been rapid. The large backlog of projects deferred during the war and the favorable financial condition of State and local governments were important factors in the increase in new construction from less than $1 billion in 1945 to more than $6¾ billion in 1952. This figure, by way of comparison, substantially exceeded the value of all private industrial and commercial construction put in place last year.

Higher construction costs have, of course, been an important factor in the rise in current dollar outlays. Although the physical volume put in place increased annually in the postwar period, the 1952 total was roughly one-third above that in either 1939 or 1929.

Table 2.—Major State and Local Government Revenue Sources as a Percent of Total Tax and Nontax Receipts, Selected Years 1929–51

[Percent]

	Calendar years						
	1929	1933	1937	1941	1945	1949	1951
Property taxes	52.0	57.1	47.3	44.3	41.2	35.0	33.7
Individual income and corporate profits tax accruals	3.7	1.3	4.1	4.0	7.2	6.6	7.2
General sales taxes	------	.9	4.9	6.0	7.0	5.3	6.0
Gasoline taxes	5.4	7.5	8.3	9.2	6.7	7.4	7.0
Liquor and tobacco taxes	------	.8	3.5	3.5	4.8	4.3	4.1
Federal grants-in-aid	1.6	7.0	8.4	7.8	7.5	11.4	10.3
Contributions for social insurance	1.8	2.4	3.5	2.7	3.3	4.1	4.6
Other	35.7	22.7	22.2	21.6	22.5	23.3	23.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: U. S. Department of Commerce, Office of Business Economics.

Steady rise in current operation purchases

State and local expenditures for current operation, including employee compensation and the bulk of other purchases except outlays for new construction, have shown an almost steady rise since 1929, and presently account for about two-thirds of total purchases. These purchases in terms of constant dollars have not declined significantly even during periods of national emergency such as the great depression and World War II.

Since the end of the war, State and local government employment has increased by about 1 million to almost 3¾ million in 1952, with both school and nonschool employment sharing in the increase. In the same period, average annual earnings have risen by more than 50 percent. As a result of these two factors, employee compensation has more than doubled since 1945, to the present annual rate of about $12 billion. Purchases for other current operating purposes have moved similarly to pay rolls and last year amounted to about $4.7 billion.

Highway and school programs

During at least the next few years, further increases in real per capita purchases may be expected. The American Association of Highway Officials has estimated that it would cost over $30 billion to bring the various Federal-aid systems to a condition of adequacy; a large additional expenditure would be required to improve non-Federal roads and streets. A recent survey of public school facilities estimated school construction needs to be of the magnitude of $10 billion. The need for improvement of hospitals and other institutions has likewise been reported to be extensive. Staffing, operating, and maintaining needed new facilities implies higher employment and operating expenses—as well as problems in recruiting teaching, health, and other specialized personnel.

Despite the rise in new construction during the postwar period, only recently have outlays come to exceed the amounts necessary to meet newly-arising requirements for facilities, and thus to allow for improving the relationship between existing facilities and requirements. The problem of acting on deferred requirements is essentially one of finance.

State and Local Government Receipts

In 1952, State and local governments received revenues in excess of $24 billion, including $2.4 billion in Federal grants-in-aid. State and local new long-term debt flotations amounted to more than $4 billion, with most of this amount going for new construction.

Unlike the Federal tax structure, which is based largely on individual and corporate income taxes, State and local governments depend upon indirect taxes to provide the greater part of their revenues. Counting miscellaneous nontax revenues from business, this category, which includes the general and selected sales taxes and the bulk of property tax collections, accounted for more than two-thirds of total revenues last year.

Personal taxes and nontaxes yielded only slightly more than one-eighth of the total receipts, with individual income taxes amounting to less than $1 billion. Federal grants-in-aid—the largest part of which are for Federal-aid highway construction and public assistance purposes—have remained quite stable since the middle thirties and account for about one-tenth of total receipts. The remainder is accounted for by contributions to social insurance, chiefly retirement funds for State and local government employees.

Receipts relative to national output

Measured as a percent of the Nation's total output of goods and services, the present burden of State and local taxes is low compared with that during the 1930's when State and local government receipts were equivalent to more than one-tenth of gross national product. This fraction declined considerably during the war years, and since 1946 has been relatively stable at around 7 percent of national product. However, with the sharp rise in Federal taxation, total tax and nontax receipts of all governments in 1952 were equivalent to more than one-fourth of national output as compared with an average of close to 16 percent during the 1930's.

Effect of price changes lagged

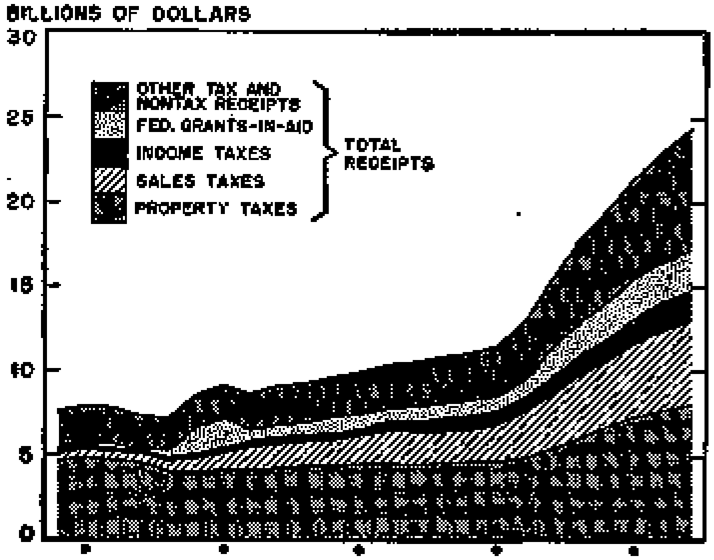
Although State and local government receipts have almost doubled since the end of World War II, expenditures have risen even more rapidly. This situation may be traced in part to the nature of the over-all tax structure of State and local governments. While purchases of goods and services promptly reflect price changes in the private economy, this is true to a much lesser extent on the receipts side of the State and local government account. This important difference may be seen by examining the tax bases of the major revenue sources.

Despite its steady decline in relative importance as a revenue producer, the property tax continues to be the most important single source of State and local government receipts (see table 2). While only a few State governments still derive a significant part of their total receipts from the general property tax, it provides more than one-half of local government receipts.

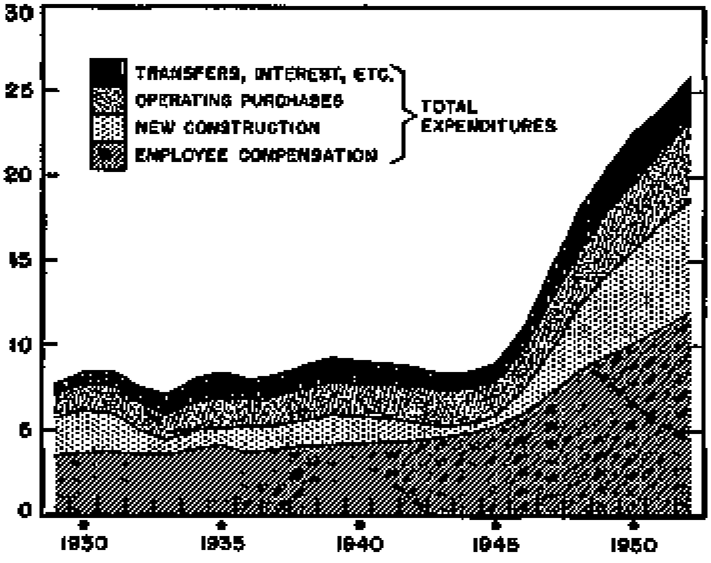
The property tax base responds to changes in business conditions, and hence price levels, only after a considerable time lag. In many communities, assessed valuations lag far behind market values so that with rising prices the effective tax rate declines. Present legal restrictions on tax rates not only vary considerably from State to State, but apply unequally within these political units.

State and Local Government Receipts and Expenditures on Income and Product Account

Although receipts have risen sharply since 1945 . . .



the rise in expenditures has been even more rapid



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This property tax situation has had an important bearing on State and local government expenditures. Although States have been providing an increasing proportion of the total cost of public education, the public school system still remains primarily a local responsibility so that the general property tax has continued and is likely to continue to be the major source of funds for public school capital outlays. Thus, the effectiveness of the property tax represents one of the factors in the present condition of the public school plant.

With respect to the other major tax bases, only the general sales tax, the individual and corporate income taxes, and contributions for social insurance expand at rates comparable to that of the value of the gross national product. However, currently these relatively new sources of revenue together account for only one-fifth of total State and local government receipts.

Other revenue bases—including the property tax—which account for about four-fifths of total receipts either are little affected by price changes or respond to them after a considerable time lag. In the case of the special excise taxes on gasoline, liquor, and tobacco, the tax base usually expands or contracts according to changes in volume rather than price. Although this aspect contributes to the relative stability of State and local receipts, particularly in time of a business downturn, the effective tax rate is reduced whenever prices increase.

Deficits and Surpluses

The State and local government deficit or surplus in the income and product account reflects the fiscal situation of these governments only with respect to aggregate receipts and expenditures, consolidating units with surpluses and those with deficits.

Due to their relative stability, State and local government receipts were sufficient to match both the current and capital expenditures of these governments for the period of the 1930's as a whole, despite deficits in particular years and the financial hardships endured by many political units.

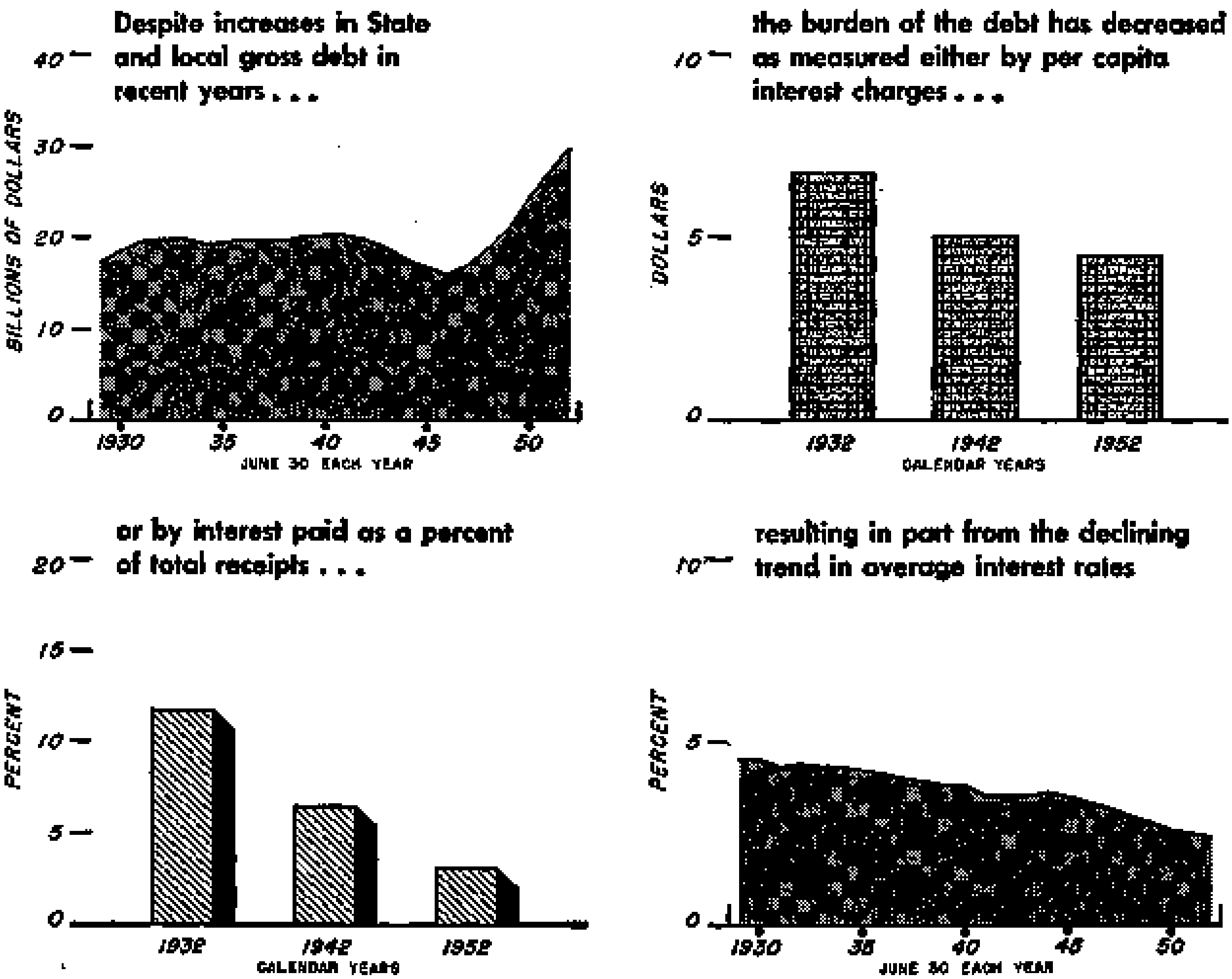
During the war and early postwar periods, the situation was particularly favorable from the fiscal standpoint. As a result of the suppression of purchases, the relatively stable State and local tax structure produced large annual surpluses from 1940 through 1947. In fact, the cumulated net surplus during this period amounted to more than $14 billion.

Since 1948, however, revenues have not kept pace with expenditures; deficits of about $1 billion have been incurred each year. As indicated earlier, this abrupt shift in the fiscal situation was the result of a combination of factors—including the extent to which price changes in the private economy affected receipts and expenditures differently, and the large increases in capital outlays for new construction.

Debt and Liquid Assets

The large surplus accumulated during the 1940–47 period not only permitted reductions in State and local debt, but

State and Local Government Debt



U. S. DEPARTMENT OF COMMERCE, OFFICE OF BUSINESS ECONOMICS 53-187 also resulted in the establishment of capital improvement funds to provide for necessary construction which had long been deferred. State and local gross debt, the bulk of which had been incurred during the 1920's in connection with school and road construction programs, remained relatively unchanged during the 1930's. However, after 1940, retirements exceeded new borrowings in every year through 1946, reducing the gross debt outstanding by more than $4 billion during these six years. Local governments accounted for about three-fourths of this total reduction, as table 3 shows.

Table 3.—State and Local Government Debt

[Billions of dollars]

As of June 30	Gross debt			Net debt [1]		
	Total	State	Local	Total	State	Local
1939	20.0	3.3	16.7	16.3	2.0	14.3
1940	20.3	3.6	16.7	16.5	2.1	14.4
1941	20.2	3.6	16.6	16.3	1.9	14.5
1942	19.7	3.2	16.5	15.9	1.7	14.2
1943	18.7	2.9	15.8	14.9	1.3	13.6
1944	17.5	2.8	14.7	14.1	1.4	12.7
1945	16.6	2.4	14.2	13.7	1.4	12.3
1946	16.0	2.4	13.6	13.0	1.0	12.0
1947	16.6	3.0	13.6	14.4	2.2	12.2
1948	18.7	3.7	15.0	16.3	2.9	13.4
1949	20.9	4.0	16.9	19.1	3.1	16.0
1950	24.2	5.4	18.8	20.7	4.0	16.8
1951	27.0	6.4	20.7	23.3	4.8	18.5
1952	29.0	7.0	22.0	25.8	5.6	20.2

1. Gross debt less State and local securities held by State and local governments.

Source: U. S. Department of Commerce, Bureau of the Census and Office of Business Economics.

Debt up sharply since 1946

Since State and local government borrowings generally precede the expenditure of these funds, gross debt commenced to increase prior to the change in the fiscal situation as reflected in the income and product account. In the six years since 1946, gross State and local government debt has increased by close to $14 billion to almost double the amount outstanding in that year. New long-term issues during this period exceeded $20 billion.

Nonguaranteed debt up sharply

One of the important factors in this $14 billion rise in gross debt has been the increasing popularity of the toll revenue and limited obligation bond method of financing. While revenue bonds have long been used throughout the country to finance municipally owned utilities, the widespread interest in them as a means to finance highway construction is a more recent development.

Revenue bonds are secured entirely by the receipts of various government enterprises, whereas limited obligation bonds are secured by the pledge of collections from particular taxes. In either case, the bonds are not backed by the full faith and credit of State and local governments and have usually been marketed only at appreciably higher rates of interest.

The nonguaranteed portion of gross State and local debt has more than doubled since 1945 to about $5 billion in June 1952. It has also increased in relative importance, presently accounting for more than one-sixth of the total. This increase is attributable in part to the amount of toll road and bridge bonds which were issued in this period.

The Bureau of Public Roads reports that toll bridge bonds and toll road bonds accounted for more than two-thirds of the $800 million rise in outstanding State highway obligations between December 1945 and December 1951. Almost $700 million of additional toll bonds were sold during 1952. Revenue bonds and limited obligation bonds accounted for almost all of the rise in State highway debt. In addition, local governments have issued more than $150 million of toll-revenue bonds for highway purposes during the past 7 years. Increased interest in revenue bonds to finance parking centers in large cities may accelerate this trend.

The gathering momentum of the toll road movement is further illustrated by the fact that as of June 1952, there were in existence only slightly more than 600 miles of modern toll roads built at an estimated cost of $.6 billion. The construction of an additional 1,000 miles estimated to cost more than $1 billion was then either under way or authorized. At the same time, other toll road proposals involving possible outlays of several billion dollars were receiving active consideration.

Liquid assets rise fivefold since 1940

Although the necessary data are not available to show total liquid assets of State and local governments, the magnitude involved is indicated by the sum of their holdings of U. S. securities and cash in banks, which accounts for the bulk of the total. State and local securities held by State and local governments are not included with liquid assets since they are netted out of gross debt.

As a result of the favorable fiscal situation during most of the 1940's, the increased holdings of sinking funds, and the net surpluses realized by the expanding trust funds, State and local government bank deposits and holdings of U. S. securities rose from about $4 billion in 1940 to almost $21 billion as of June 30, 1952 (see table 4). These figures do not include the deposits of States, currently amounting to more than $8 billion, with the U. S. Treasury in connection with the unemployment compensation program. While it is not possible to segregate State liquid asset holdings from those of local governments except in 1951, available data suggest that States experienced the largest relative increase in their holdings. According to the Census Bureau, total cash and security holdings of States, excluding deposits with the U. S. Treasury, amounted to more than $12 billion in 1951.

Table 4.—Major Cash and Security Holdings of State and Local Governments [1]

[Billions of dollars]

As of June 30	Liquid assets				Liquid assets as a percent of net debt	State and local securities held [2]
	Total	U. S. securities held	Bank deposits			
			Demand	Time		
1939	4.2	0.4	3.2	0.6	21	3.7
1940	4.1	.4	3.2	.6	25	3.8
1941	4.7	.6	3.0	.6	30	3.9
1942	5.2	.9	3.8	.5	33	3.8
1943	6.2	1.5	4.3	.4	42	3.8
1944	8.3	3.2	4.0	.5	59	3.4
1945	10.7	5.3	4.8	.6	78	2.9
1946	13.1	6.6	5.9	.8	96	2.3
1947	14.1	7.1	6.1	.9	98	2.4
1948	16.3	7.8	7.3	1.2	100	2.5
1949	17.0	8.0	7.6	1.4	94	2.7
1950	18.3	8.7	8.1	1.5	88	3.5
1951	19.5	9.4	8.6	1.6	84	3.7
1952	20.9	10.3	8.9	1.7	81	3.9

1. Excludes deposits of States with U. S. Treasury.
2. State and local securities held by State and local governments are excluded from liquid assets since these securities represent the duplicating portion of gross debt.

Source: U. S. Department of Commerce, Office of Business Economics, based largely on data from the U. S. Department of the Treasury, Federal Deposit Insurance Corporation, and Comptroller of the Currency.

Although only a small part of the $21 billion total is held by sinking funds as offsets to long-term debt, a comparison of the current ratio of liquid assets to net debt with that in past years suggests the improved financial condition of State and local governments. Despite some decline in this ratio in recent years, State and local government holdings of United States securities and cash in banks in June 1952 were much larger with respect to their outstanding net debt and operating expenses than in the prewar period.

A large part of these holdings is owned by State and local employee retirement funds and various other sinking and trust funds, and hence is not available for expenditure for general government purposes. However, it would appear from Census reports on the cash and security holdings of States and cities over 25,000 that probably close to one-half of the total remains after deducting offsets to long-term debt and holdings of insurance and employee retirement trust funds. At the close of fiscal year 1951, State governments alone held $7 billion of assets after these deductions. Although working capital requirements and other encumbrances account for part of those liquid assets which are neither in the form of offsets to debt nor held by trust funds, the magnitude of the total suggests that a considerable sum remains available to finance future current and capital outlays

These cash and security holdings are of significance from the standpoint of monetary and fiscal policy. Since they represent an important part of the total money supply, large shifts as between the various types of assets could have marked economic consequences. In addition, the mere existence of assets of this magnitude would tend to reduce the dependence of State and local governments upon the market for new long-term capital in the event of a serious economic decline.

Data showing annual debt retirements, including sinking fund requirements, are not available; the trend of the burden of debt servicing can be shown only in terms of the interest charges. It does appear, however, that State and local debt retirement requirements have been relatively stable.

As the chart indicates, total interest charges have declined relative to either State and local receipts or population during the past two decades. With the relative decline in interest charges as compared with receipts, a decreasing share of revenues has had to be devoted to this purpose. This downward trend has continued, though at a slackened rate, despite the large increases in outstanding debt in recent years. One of the factors in the relative decline in interest charges—falling average interest rates—may work in the opposite direction in the future. At present it appears that new capital may be available only at somewhat higher interest rates.

The improvement of the Nation's schools, highways and other State and local government institutions is essentially a problem of finance. In view of the over-all financial position of State and local governments, it would appear that debt creation could provide at least part of the necessary funds but this may raise problems with respect to legislative and constitutional limitations on further debt and tax increases.

The Business Situation

(Continued from p. 8)

was equal to approximately 11.7 percent of total consumer expenditures and that repayment of installment debt was about 9.5 percent of disposable income.

Consumers satisfied their needs by the use of installment credit to a greater degree in 1952 than in any recent year and also more than in the years immediately preceding World War II. As a corollary to this freer use of credit, installment debt repayment absorbed a higher fraction of disposable personal income in 1952 than in any recent year.

Effect of changing composition of purchases

A part of the postwar growth of consumer credit is accounted for by the expanding sales of goods customarily sold on installment credit. These are largely durable goods, with automotive products giving rise to the largest volume of credit and furniture and other household equipment next in importance. The accompanying chart shows the contribution of the various types of goods to installment sale credit outstanding. Whereas in 1945, as a result of wartime conditions, purchases of consumer durables accounted for 6.9 percent of total consumer outlays, in recent years the proportion of durables has averaged nearly double that amount; the proportion spent for automobiles and parts shifted from less than 1 percent in 1945 to slightly less than 5 percent in 1952.

Liberalization of terms

An important part of the postwar growth of consumer credit is ascribable to the liberalization of credit terms. The size of the down payment is a major factor governing the amount of credit extended while the total amount outstanding is determined, in addition to the size of the down payment, by the length of time permitted for repayment.

On all three occasions since the end of World War II when consumer credit controls have been suspended, progressively more liberal credit terms than those permitted by Regulation W have been granted by merchants under pressure of competition. On each occasion, the volume of credit outstanding has grown rapidly under this stimulus to buying. In the most recent of these three periods, running since last May 7, there has been the usual reduction in down payments and lengthening of repayment periods. On automobiles, for example, indications are that 24 months is currently the prevailing maturity period as compared with the 18-month maximum in effect prior to the suspension of Regulation W.

Credit use more widespread

There is some evidence that the proportion of buyers using credit is also continuing to expand. The Board of Governors of the Federal Reserve System reported in December that since the lifting of credit controls last May, more durable goods purchases were being financed on credit than prior to that time. This is particularly true of new autmombiles which an estimated 47 percent of all buyers purchased with the aid of credit in 1951; preliminary data indicate that a considerably larger percentage of new car purchases in 1952 have involved the use of credit.